# High Growth Conference Summary

***Introduction***

Small businesses play a critical role in supporting economic growth and creating jobs. Over the past fifteen years, small firms have been responsible for creating two out of every three net new jobs in the U.S. economy. Importantly, a specific subset of these small businesses accounts for a disproportionate share of job growth and innovation. These "high-growth" firms have different needs, face different barriers, and require different policies than the traditional "Main Street" small business.

As the economy continues to recover and grow, the U.S. Small Business Administration (SBA) is committed to serving as the strongest possible voice for these high-growth small firms. Already, the SBA has convened experts from a variety of fields and backgrounds to discuss the characteristics of high-growth businesses, barriers these businesses face, and how the government can maximize their already-strong impact on innovation and job creation.

On March 15, 2010, SBA cosponsored a forum with the Brookings Institution to build an intellectual foundation and to better understand high growth firms. Leaders from academia, think tanks, and policy experts examined the existing data and research on high-growth firms from every possible angle. Individual participants thought that government should focus on eliminating barriers and fostering an environment for high-growth firms to grow and thrive. In sum, the three overarching findings from this forum were:

1. Startups play a crucial role in job creation
2. Mature high-growth firms from every county and every industry in America contribute meaningfully
3. High-growth firms as a whole are driving innovation and global competitiveness, helping usher in the next generation of "great American companies"

Building on the March 15 forum, in May, the SBA invited practitioners – including entrepreneurs, policy makers, venture capitalists, and legal experts – to a High Growth Conference to discuss specific ideas for the role of government in supporting high-growth firms. The group discussed barriers facing high-growth small businesses, ways in which the government can help reduce these barriers, and areas in which the government can do more – or less – to support high-growth firms.

The attendees at the May 4$^{th}$ Conference discussed guiding principles at each stage of firm growth: how to help startups get a stronger footing in the market, how to support firms that are trying to cross the "Valley of Death" (the gap between research and commercialization) and achieve early-stage growth, and how to help firms to scale up and grow as quickly as possible, in order to be competitive globally while maximizing employment in the U.S.

The SBA has compiled a summary of the individual viewpoints, ideas, suggestions and talking points into this narrative summary which SBA hopes will contribute to the on-going discussion of how government can best support high growth firms. This summary reflects the recurring theme of individual conference participants for the need for policies that are tailored to particular industries rather than a "one size fits all" solution. The policy suggestions outlined in this summary have costs, benefits and implementation issues which require further evaluation which is beyond the scope of this summary.  This summary does not reflect the official views of SBA.  It is simply an attempt to capture the ideas proposed by participants in a form that may be used to stimulate additional conversations.

### Increase Access to Capital Across All Stages of the Life Cycle

- Support angel investment, including simplifying and modifying tax policy
- Address gaps and remove impediments in early stage equity
- Increase access to traditional credit

### Improve Access to Talent

- Increase talent available for high-growth companies, modernizing immigration laws
- Infuse more entrepreneurial skills training into the U.S. education system

### Celebrate Entrepreneurship and Focus on Increasing the Number of Start ups

- Decrease cost and friction associated with business creation
- Facilitate mentorship for early-stage entrepreneurs
- Foster a national celebration of entrepreneurship

### Strengthen the Underlying "Innovation Ecosystem"

- Consider new market structures, technologies, and SEC rule changes to improve liquidity and capital formation
- Update the intellectual property system, including patents
- Systematically evaluate impact of regulation on innovation
- Develop incentives to keep high-growth businesses in the U.S. and hire U.S. talent

### Leverage Government Programs More Effectively

- Increase Federal research & development spending on applied research
- Make access to government programs easier and more understandable to small businesses

***Section I: Increase Access to Capital across All Stages of the Life Cycle***

**Support angel investment, including simplifying and modifying tax policy**
A participant highlighted the importance of investments from friends, family, and others (i.e., angel investment) in the formation of new companies, especially given that bank lending and types of venture capital investment are primarily for more mature companies. Additional ideas, emphasizing tax policy simplification and modification to create incentives for angel investment included:

- **Incentives at time of angel investment:** Put in place tax credits for angel investment, which has been successfully enacted in a number of states (e.g., Wisconsin).
- **Incentives on back-end of investment (e.g., capital gains):** Provide tax preferences on the back-end of an investment, such as enacting preferable or no capital gains treatment on income earned from angel investing. One participant noted that this rewards the most successful angel investments rather than all investments.
- **Simplify the tax and accounting rules:** Despite numerous tax breaks that exist, complex rules make them difficult to use, even for sophisticated professional investors. Examples of these complex rules include taking advantage of rollovers, or knowing whether angel investment meet the Qualifying Small Business standard for preferential capital gains treatment.
- **Concern about proposed changes to the accredited investor rule:** Participants were concerned that the proposed accredited investor rule could have the impact of significantly reducing the overall level of angel investment and reducing the number of angel investors. Participants suggested ideas such as exempting investments below a minimum floor (e.g., $25-50K) or below a percentage of an individual's net assets. Participants also expressed concerns about proposed filing requirements and waiting periods.
- **Incentives for community-based angel investment:** The government should focus on spurring angel investment in specific underserved communities. This could be accomplished through the CDFI Fund, utilization of New Market Tax Credits, or other existing incentives.
- **Support for "Angel Networks":** Provide funding to directly support angel networks or efforts to facilitate entrepreneurs access to potential angels, such as a searchable database for potential angels to find entrepreneurs and vice versa.

**Address gaps and remove impediments in early stage equity**
Another participant noted that earlier stage firms need equity rather than debt capital, and cited the shrinking availability of capital in early stage equity, particularly the "Valley of Death." They suggested that the appetite for risk among venture firms in many sectors has disappeared and offered the following suggestions to enhance high-growth firms' access to early stage equity and venture funding:

- **Retool existing funding investments:** Policy makers should consider retooling existing funding mechanisms (e.g., SBICs, state funds) to support investments in the $1-$5 million range. Participants specifically called for equity investments in these businesses.
- **Create "American Idol" for start ups (Government VC):** Create a government sponsored business plan competition (i.e., "American Idol" for startups) as a highly publicized

national competition that sets aside $1 billion to provide 1,000 winning companies with $1 million each. The loans would charge 5% interest and be paid back over 5 years. Israel currently has a similar program with $1 million loans to be paid back upon a liquidity event.

- **Eliminate capital gains taxes on small business investment:** Several participants stated that the elimination of capital gains taxes on small business investment would induce individuals to provide sorely needed capital to start ups and small businesses. Given differences between venture and private equity investing, the elimination of capital gains taxes could be applied solely to venture investing if needed.
- **Increase SBIC funding:** More capital should be allocated to SBICs, which would ideally be provided equity with no interest or low interest with principal amortization. One participant called SBICs "the right people to find gazelles and provide them capital."
- **Increase SBIR Funding:** The SBIR program has provided start up grant funding for entrepreneurs throughout the U.S. This program provides a solid foundation to build on in crossing over the Valley of Death. It is also a bridge that connects research, innovation, and commercialization.

There are several countries that support venture funding for small businesses through tax incentives. Such an incentive could also reduce occurrence of short selling, which often steers businesses away from going public.

**Increase access to credit**

Although angel investments and equity capital are central to high-growth firms, there is a lack of access to this and other types of credit for small businesses. It was noted that in other countries government advocacy for lending immediately translates into loans, which is not the case in the U.S. Consequently, participants provided several suggestions for the improvement of access to capital:

- **Eliminate the personal guarantee:** Incentives need to be created to induce banks to lend to small businesses. Although the SBA guarantee in many ways accomplishes this, the personal loan guarantee required by entrepreneurs is an insurmountable hurdle. One participant noted, "No Gazelle (i.e., high-impact; high-growth) entrepreneur would risk that much."
- **Support the predictability of interest rates:** Although some entrepreneurs do have access to capital, many are afraid to use it. This is grounded in the unpredictability of interest rates, which could shoot up at any time. For example, there is a fear that LIBOR will increase dramatically. Consequently, government should support the creation of loans with a fixed range of interest rates for a 5-year period.
- **Eliminate timing issues:** Loan approval and disbursement timing creates a major debt issue for small businesses. As compared to China and Malaysia, the U.S. is extremely slow in disbursing grants or working with banks on loan disbursement. This gap makes U.S. companies less competitive in the global market, and the government should make provisions to speed up the process.
- **Consider innovative market structures:** The government could improve access to capital and liquidity by considering new technologies and market structures for smaller companies consistent with investor protection, such as restricting access to such a "middle market" to investors that do not require registration level protection.

*Section II: Improve Access to Talent*

**Increase talent available for high-growth companies, including modernizing immigration laws**
Several participants noted that current immigration laws limit the amount of talent available for high-growth U.S. companies. Several solutions to this problem were offered:

- **Start up visas:** Change immigration laws to allow for start up visas for entrepreneurs interested in coming to or staying in the U.S. to start a business that will create American jobs.
- **Green cards for STEM graduates:** The government could meaningfully increase the pool of high quality talent by providing a green card to any foreigners who graduate from an American University in a STEM (Science, Technology, Engineering, and Mathematics) field. One participant argued that universities should be able to "staple a green card to their students' diplomas." Others noted that existing visa programs, like H1B, favor larger companies and are more difficult for smaller entrepreneurial ventures to utilize.
- **Military service green card:** A military service green card, for non-citizen American servicemen and women, should also be provided, combined with entrepreneurial training and counseling for interested vets.
- **Incentives for companies to hire recent graduates:** The government could provide incentives or subsidies for hiring recent graduates into entrepreneurial companies.

**Infuse more entrepreneurial skills training into the U.S. education system**
Inadequate education was highlighted as systemic to many entrepreneurship and innovation problems. Many participants argued that the U.S. education system suppresses people who create disruptive ideas and think alternatively.

- **Invest in STEM:** The U.S. government should focus resources on augmenting U.S. STEM (Science, Technology, Engineering, and Mathematics) education. Through additional funding and curriculum mandates, STEM education would make U.S. educated citizens more competitive in the global landscape and able to innovate.
- **Support vocational training:** There is a major gap that exists between high-paying vocational positions in the U.S. and training centers. For example, welders in nuclear plants make $350,000 annually, but there are only three training centers in the entire country. As a result, the government should foster the creation of more vocational training programs for new industries and sectors.
- **Include entrepreneurship as part of every curriculum:** Entrepreneurship should be included as a part of all curriculums (a suggestion was to "add another E to STEM"). Through formal entrepreneurship training people will be better equipped with the tools necessary to innovate.

***Section III: Celebrate entrepreneurship and focus on increasing the number of Start ups***

**Decrease cost and friction associated with business creation**

A participant identified the need to decrease the cost, time, and general friction associated with starting a company, which are identified as key roadblocks to innovation. To decrease cost and friction associated with business creation, participants provided several suggestions:

- **State ease-of-business-formation index:** Participants discussed the usefulness of ranking states by the ease of new business formation, similar to the World Bank's Ease of Doing Business Index. Such a ranking or tiered system would foster competition between states to reduce the burden of paperwork to start a business.
- **Reduce barriers from non-compete agreements:** Non-compete employment agreements are a severe impediment for entrepreneurs to start a company. In early-stage start up companies in U.S. hot spots, employees frequently "turn over" leading to increased risk of litigation associated with non-compete agreements. As a result, many employees are hesitant to start their own companies.
- **Streamline IP agreements with employers:** IP agreements with employers create a disincentive for employees to start their own companies. One solution to streamline intellectual property agreements with employees is to account for longer patents to be issued. The Patent Office should seek to accelerate the time needed for office actions on a patent application.
- **Hiring-and-retaining tax credits with clawback provisions:** At one point Canada had a program that provided tax credits with clawback provisions; however, the program required businesses to remain in Canada, or forfeit (and repay) the credits. New York City also had a similar clawback provision in business emergency loans it provided following the "Great Blackout".

**Facilitate mentorship for early stage entrepreneurs**

Participants noted a significant need for high-quality mentorship for startups and potential high-growth companies. Mentorship is frequently found in U.S. hot spots from angel investors and venture capitalists; however, outside of these "ecosystems" almost no mentorship exists. Furthermore, the importance of facilitating mentorship cannot be undervalued. Specific proposals to foster mentorship for early stage entrepreneurs were provided:

- **Start up-freelancer co-working spaces:** Co-working spaces, where start up companies and freelancers work together, could be important to developing a culture of entrepreneurship and attracting mentoring relationships. Such co-working centers could be funded and developed around burgeoning research institutions that are in need of such centers.
- **Virtual alumni entrepreneurial networks:** Carnegie Mellon has a current effort to pool contact information between the offices of alumni relations, corporate relations, and tech transfer to create a virtual alumni diaspora for entrepreneurship "networking on steroids". This has been bringing experienced advisers, investors, and executive talent, now in high-level positions worldwide, to the university's spinoff companies as a way to support regional economic growth. This collaborative effort is unique as compared with other universities which keep such alumni information in silos.
- **Business acceleration services:** There should be a clear policy distinction between traditional business counseling for Main Street and counseling services associated with high-growth enterprises. Business acceleration counseling should focus on narrowing the gap between idea and commercialization and should facilitate access to capital.

Specific policy recommendations include tailoring a suite of business counseling and strategic consulting services exclusively to the needs of high-growth entrepreneurs and enterprises.

**Celebrating and Encouraging Entrepreneurship**

The importance of strong role models to encourage start up creation and innovation was also discussed. Role model celebration must be done on the local level in innovation hot spots (i.e., Silicon Valley, Research Triangle) as well as on the national stage. Consequently several suggestions for celebration were offered:

- **Advocacy for U.S. "Hot Spots":** There should be strong recognition of innovation and entrepreneurship as a cultural issue, via highlighting U.S. hot spots that support entrepreneurship and the mechanisms that do so (i.e., tax incentives, corporate climate).
- **Competitions for expansion**: The government should sponsor high profile competitions, such as the "American Idol" for startups or other competitions for expanding businesses (e.g., building a low-cost plant in South Dakota). This could greatly enhance the national focus on entrepreneurship.
- **Entrepreneurship in education:** Government celebration of entrepreneurship and innovation should begin in schools and be added to curriculums across the country. "Lemonade Days" in Minnesota is a prime example of curriculum-based entrepreneurship. Entrepreneurship education would not only foster the creation of start ups but also increase graduation rates among budding entrepreneurs who do not see value in a school education. The *Young President's Organization* was mentioned as a potential partner in this effort.
- **Add an "E" for Entrepreneurship to "STEM":** In addition to focusing U.S. education on science, technology, engineering, and mathematics, there should be a concerted focus on entrepreneurship. Through formal entrepreneurship training, students not only acquire tools necessary to innovate but also build a strong understanding of how to foster growth and recognize entrepreneurial role-models through the study of cases.
- **Incent recent graduates to start businesses**: The government could provide incentives or subsidies for recent graduates to start entrepreneurial companies. Through this "Innovate for America," recent graduates who want to start a business would be provided a financial cushion or pay-down of student debt.

***Section IV: Strengthening the Underlying "Innovation Ecosystem"***

**Modify SEC rules to improve liquidity and capital formation**

Participants highlighted the importance of modifying current SEC rules to improve access to liquidity, as well as capital formation for small businesses. Several SEC rule modifications were suggested.

- **Amend public offering regulations:** Current SEC regulations require any company with 500+ shareholders and meeting certain other requirements to register with the SEC as a public reporting company. As the timeline to an IPO has lengthened, requiring more rounds of financings and other stock issuances, this threshold should be reconsidered.

For example, accredited investors or other classes of investors deemed not to need registration level protection could be excluded from the count or the threshold increased in light of the changed environment.

- **Ban "naked shorts":** Many entrepreneurs have a fear of "naked shorts" (i.e., selling assets that have been borrowed from a third party with the intention of buying later) by hedge funds ahead of an IPO. This fear prevents many maturing companies from going public which, in turn, prevents job growth ("92% of job growth in my portfolio came after public offerings"). As such, the SEC should ban "naked short" selling by hedge funds ahead of IPOs.
- **Consider alternative market structures and the use of new technologies:** The creation of new market structures providing broader access to capital and secondary trading for investors deemed not to need registration level protection, such as VCs and sophisticated "angel" investors, should be considered in light of the lengthening IPO period and the global competition for listings. Such a market could provide more efficient access to capital and reduce liquidity pressures for companies not yet ready for full public listings.
- **Permanent SOX exemption for small business:** Sarbanes-Oxley provisions, enacted in 2002, place a large constraint on small businesses, related to reporting and internal controls, which is often detrimental to small, growing businesses. As a result, a SOX exemption for small businesses could spur further growth and innovation.

**Revise the intellectual property system, including patents**

Another participant noted that the current IP system, specifically surrounding patents, creates a major roadblock for entrepreneurs. Participants cited that while the patent system was designed by "creators" looking to protect their intellectual property, it is currently exploited by "patent trolls". Furthermore, patents are held by unsuccessful companies. The net effect is that rather than incenting innovation by protecting IP, the current patent system actually discourages and inhibits innovation in many sectors of the economy, particularly software.

- **Reevaluate the rubric of IP rights and change the current system that favors trolls:** Specific ideas ranged from eliminating the patent system for certain industries, (e.g. software) or formalizing an independent invention defense policy.

**Systematically evaluate impact of regulation on innovation**

Participants cited concerns about the "unintended consequences" of federal regulation on the innovation ecosystem.

- **Robust processes to evaluate potential impact of new regulations:** An independent body could parallel the SBA's Office of Advocacy's current evaluation of the impact of regulation on broader small business interests.

**Develop incentives to keep businesses in the U.S.**

Participants noted the need to keep businesses in the U.S. as companies mature. Many contend that the U.S. manufacturing base is much more effective than recognized, consequently requiring an image makeover to revitalize growth in the industry. Several suggestions for revitalization were provided:

- **Creating U.S. "insourcing" case studies:** The creation of case studies and analyses on "insourcing" (jobs coming back to the States after offshoring experiences) could create a more realistic and positive picture of the costs of outsourcing and the viability of U.S. manufacturing.
- **Labor costs within U.S. tax structure:** Currently, the cost of labor for small companies can be prohibitive for labor reform within the U.S. tax structure (i.e., visas). The U.S. should evaluate alternatives to the current labor cost structure to encourage start-ups and small businesses.

***Section V: Leverage Government Programs More Effectively***

**Increase Federal research & development spending on applied research**
Several participants cited an increased allocation of Federal money spent on applied research as a unique solution towards inducing business creation. The current perception is that the return-on-investment of Federal research money is "philanthropy". Several solutions to this problem were offered:

- **ROI of research:** Research may have a longer time-horizon for return-on-investment than most venture capitalists are willing to tolerate. Federal research money would prolong research efforts that venture capitalists are hesitant to invest in. The necessary invitation for venture funding is evident in the severely underfunded NSF engineering program.
- **Technology transfer initiatives:** Technology transfer initiatives and efforts focused on people (not concepts) increase the likelihood of spin-out companies from applied research. Prime examples of success are City-based Innovation Works, the Heinz Endowment, and Carnegie Mellon University in creating spin-out companies from their technology transfer efforts.

**Make access to government programs easier and more understandable**
Participants noted a severe lack of awareness among entrepreneurs and venture capitalists of SBA programs and other government support. As a result, a majority of participants suggested several changes to facilitate an entrepreneurs understanding of government support programs, as well as augmented support. The ideas focused on how to *organize, aggregate and scale* current efforts.

- **Portal:** The lack of awareness about SBA loan and counseling programs has raised a need for the creation of a "one-stop-shop" for entrepreneurs. This need could be satisfied through an online portal clearly displaying all SBA offerings as well as links and contact information for participation in programs.
- **Government case officer:** Although support for government procurement and export opportunities is well funded and staffed, more direct support is necessary through a government case officer. Such a case officer may not scale to support 6 million businesses, but this role could serve a strong subset. Further, a government case officer can identify key businesses with growth and job potential to support.